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No. 85-1368

IN THE
SUPREME COURT
OF THE UNITED STATES
October Term, 1985

LAWRENCE J. GALARDI AND SHARI J. GALARDI,

Petitioners,

vs.

TOKAI BANK OF CALIFORNIA, a California Corporation, et al.,

Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Were Petitioners denied a right to a jury trial?

2. Did the District Court properly review the Bankruptcy Court's findings of fact and conclusions of law and enter judgment thereon?

3. Did Section 404(d) of the Bankruptcy Reform Act of 1978 continue the District Court's appointment powers, permitting the District Court to appoint a retired bankruptcy judge as a bankruptcy judge pursuant to Section 40(d) of the Bankruptcy Act?

4. Should the Supreme Court grant *certiorari* when no important question of federal law is presented and when the decision of the Ninth Circuit is firmly based on long-standing authority?

INTERESTED PARTIES

Respondents submit that in addition to those persons specified as interested parties in the Petition for Writ of Certiorari, the following persons may arguably have an interest in the outcome of the case before this Court:

(1) Donald L. Lewis, a subsequent owner of the real property located at 20731 Cool Oak Way, Malibu, California; and

(2) Eagle Pass Associates, a California Limited Partnership, a subsequent owner of the real property located at 20600 Eagle Pass Drive, Malibu, California.

Dated: March 10, 1986

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TOKAI BANK OF CALIFORNIA

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LAWRENCE J. GALARDI AND SHARI J. GALARDI,

Petitioners,

vs.

TOKAI BANK OF CALIFORNIA, a California Corporation, et al.,

Respondents.

OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

I

STATEMENT OF THE CASE

This litigation arises out of an auction of two parcels of real property which had been part of the Petitioners' bankruptcy estate. The auction was conducted by the Chapter 7 bankruptcy trustee pursuant to an order of the Bankruptcy Court approving the sale. This Petition for Writ of Certiorari represents the final chapter in the saga of Petitioners' unrelenting efforts to thwart the trustee's

proper exercise of his statutory duty to liquidate the property of the debtors' Chapter 7 estate.

A. Petitioners' Challenge of the Auction and the District Court Judgment .

On November 24, 1982, the Bankruptcy Court entered an order directing the trustee to conduct an auction sale of two parcels of real property of the Galardi bankruptcy estate. The order approving the sale was granted upon the joint application of the Chapter 7 trustee, David A. Gill, and Tokai Bank of California, the holder of first deeds of trust on the two parcels of property.[1] The sale was conducted on December 12, 1982.

Thereafter, on January 20, 1983, Petitioners filed an *unverified* Application before the Bankruptcy Court requesting the Court to set aside the auction sale and to quiet title to the real property in Petitioners' name. In light of Petitioners' challenge to the trustee's conduct of the sale under the Court's order, and the need for substantial documentary and testimonial evidence to be presented on those claims, the Bankruptcy Court entered an order on March 18, 1983 specifying that if Petitioners sought to pursue their claims, the claims should be made in the context of an adversary proceeding rather than by motion or application. Thereafter, Petitioners filed a complaint seeking substantially the same relief requested in the Application.

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[1] Petitioners filed a notice of appeal of the Court's order approving the sale. Petitioners did not request a stay of the order, and the appeal was dismissed for lack of prosecution.

A ten-day trial on the merits of the complaint was held before the Bankruptcy Court, Judge Russell B. Seymour presiding. Mr. Galardi, an experienced trial attorney, conducted the trial on behalf of Petitioners. No request for a jury trial was made by Petitioners in the application, the complaint, or at any time during the course of the trial.[2] The jurisdiction of the Bankruptcy Court was based upon the Emergency Rule for the Central District of California, promulgated after the stay of the *Marathon* decision expired.

The bankruptcy judge submitted findings of fact and conclusions of law, a Report and Recommendation, and a proposed judgment to the District Court. These documents were lodged more than seven weeks after the conclusion of the trial, and after the Bankruptcy Court had held the documents for one week to provide Petitioners an opportunity to file written objections.[3] The District Court signed the judgment on September 16, 1983, and the judgment was entered on September 26, 1983.

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[2] Petitioners failed to request a jury trial pursuant to Bankruptcy Rule 9015, and expressly stated at the commencement of trial that they had chosen to try the case before the judge without a jury. Further, no jury trial was required because the case was a "core proceeding" since Petitioners were challenging the method and manner of the trustee's liquidation of property of the Chapter 7 bankruptcy estate.

[3] At the conclusion of trial, Petitioners advised the Court that they would file objections to the proposed findings and conclusions and a memorandum of law in support of their position. They also acknowledged that they would have the right to file a motion seeking to amend any documents signed by the Court.

B. Issues Presented to the Court of Appeals and Affirmance of the District Court Judgment

The decision of the Ninth Circuit confirms that the claims asserted by Petitioners were "core" matters arising under the bankruptcy laws and that the Bankruptcy Court's exercise of jurisdiction over the proceeding was valid under the Emergency Rule since Petitioners sought equitable relief and challenged the Chapter 7 trustee's conduct in liquidating the estate. Petitioners therefore had no constitutional right to jury trial.

The Court further found that the District Court properly reviewed the proposed findings of fact and conclusions of law and entered judgment accordingly. The Court noted that Petitioners filed no objections to the findings, conclusions, and proposed judgment and held that the District Court therefore properly based its determination on the pleadings and papers which it had before it.

As to the issue of the appointment powers of the District Court, the Court found that the appointment was expressly authorized under the powers reserved to the District Court in Section 404(d) of the Bankruptcy Reform Act and Section 40(d)(2) of the Bankruptcy Act of 1898. Under the Bankruptcy Act of 1898, courts of bankruptcy are defined in Section 1(10) as the district courts, and Section 404(a) of the transition statutes continued the existing courts of bankruptcy under the former Bankruptcy Act until March 31, 1984.

The Court of Appeals also found full support in the record for the judgment and the findings that the auction sale was properly conducted in all respects and that it was Petitioners who attempted to disrupt the sale and cause confusion. For a more complete recitation of the underlying

facts of the case which details Petitioners' scheme to cloud title to the properties and discourage bidders at the auction sale, please see the procedural and factual history of the case from Respondent's brief submitted to the Court of Appeals for the Ninth Circuit, attached hereto as Appendix 1.

II

SUMMARY OF ARGUMENT IN OPPOSITION TO GRANT OF CERTIORARI.

The case at bar is nothing more than a routine bankruptcy proceeding in which the Chapter 7 debtors have objected to the Chapter 7 trustee's manner of liquidating property of the estate. The case presents no special questions of federal law, no unique facts, and no unsettled legal issues. To the contrary, the decision of the Court of Appeals affirming the judgment is based on substantial, well-settled and well-reasoned authority.

In this case, the Court of Appeals for the Ninth Circuit held that under the authority of *Katchen v. Landy*, 382 U.S. 323, 336-340 (1966), there is no constitutional right to a jury trial in a bankruptcy proceeding such as the core proceeding at issue. Moreover, Bankruptcy Rule 9015 provides a specific mechanism by which Petitioners could have requested a jury trial. No request for a jury trial was ever made by the Petitioners, and the transcript of the trial reveals an *express acknowledgment on the part of Mr. Galardi that he deliberately chose not to request a jury trial. See, Reporter's Transcript,* (hereinafter "R.T.") June 21, 1983, 62:23-63:2.

As to Petitioners' contention that the District Court failed to review the determination of the Bankruptcy Court, the District Court reviewed the findings of fact and conclusions of law, the report and recommendation and the proposed judgment. Petitioners made no objection to the proposed findings and judgment. Petitioners submitted no legal memoranda or other pleadings or additional evidence to the District Court or the Bankruptcy Court, and Petitioners made no request for a hearing before the District Court, despite Petitioners' attempts to suggest otherwise. *See*, Petition for Writ of Certiorari, page 17.

As to the appointment of a retired bankruptcy judge, the transition statutes of the Bankruptcy Reform Act of 1978 expressly provide that Section 40(d)(2) of the former Bankruptcy Act was to remain in effect through March 31, 1984. *See*, Section 404(d) of the Bankruptcy Reform Act of 1978. The transition statutes further provide that the courts of bankruptcy, defined as the district courts under Section 1(10) of the Bankruptcy Act of 1898, were to also remain in existence until March 31, 1984. Section 40(d) of the former Bankruptcy Act grants the District Court the authority to call upon retired bankruptcy referees to perform bankruptcy duties.

ARGUMENT

III

PETITIONERS WERE NOT DENIED THE RIGHT TO A JURY TRIAL.

Petitioners at no time requested a jury trial and made no reference to a request for a jury trial until final argument at the trial on July 18, 1983. Mr. Galardi, an experienced trial

attorney, was apparently fully aware of his rights and made a conscious decision to try the matter before Judge Seymour. That Petitioners knowingly and deliberately chose not to request a jury trial is clear from the record of the proceeding. As Mr. Galardi stated:

> We don't have a jury here. *I could have asked for a jury trial.* I am confident that you are going to sort the wheat from the chaff as my learned friend suggests. Every judge I have ever been before in my life has been able to do that. (Emphasis added.) R.T., June 21, 1983, 62:23-63:2.

Further, as the United States Court of Appeals for the Ninth Circuit noted, this case is clearly a core proceeding arising under the bankruptcy laws. The claims of Petitioners strike at the heart of a Chapter 7 proceeding by challenging the Chapter 7 trustee's actions in conducting the liquidation. The right of the Bankruptcy Court to exercise jurisdiction over such a "core" proceeding was held to be constitutional in the *Marathon* decision, and the Bankruptcy Court's power to adjudicate "core" proceedings was confirmed through the Emergency Rule for the Central District of California.

Since a Bankruptcy Court is a court in equity, there is no constitutional right to a jury trial. *See, Katchen v. Landy, supra.* Further, the relief sought by Petitioners in their complaint includes claims for declaratory and injunctive relief, matters in equity for which there is no right to a jury trial.

IV

THE DISTRICT COURT'S REVIEW WAS CONDUCTED IN ACCORDANCE WITH THE EMERGENCY RULE AND SATISFIED THE REQUIREMENTS OF DUE PROCESS OF LAW.

Petitioners argue that their due process rights were abridged either (1) by the Bankruptcy Court exercising jurisdiction over the proceeding regardless of whether the bankruptcy judge was supervised by the District Court, or (2) by the District Court allegedly failing to review the Bankruptcy Court's decision as a required under the *Marathon* decision and the Emergency Rule promulgated thereafter. Regardless of how Petitioners frame the alleged constitutional violation, their arguments have no merit and were properly rejected by the Ninth Circuit.

A. The Emergency Rule and the District Court Reference of the Adversary Proceeding Were Constitutional.

The adversary proceeding at issue was filed after the decision of this Court in *Northern Pipeline Construction Company v. Marathon Pipeline Company*, 458 U.S. 50 (1982), and after the stay of the *Marathon* decision had expired. The trial was held before the bankruptcy judge pursuant to the general order of reference contained in the Emergency Rule promulgated by the District Court for the Central District of California.

The Circuit Courts of Appeal which have been asked to decide the issue have consistently held that the *Marathon* decision had no effect on the grant of bankruptcy

jurisdiction to the district courts contained in 28 U.S.C. Section 1471(a) and 1471(b). *See, e.g., In re Thomas*, 765 F.2d 926, 929 (9th Cir. 1985); *In Re Kaiser*, 722 F.2d 1574, 1578 (2d Cir. 1983); *Oklahoma Health Services Federal Credit Union v. Webb*, 726 F.2d 624 (10th Cir. 1984); *White Motor Corp. v. Citibank*, N.A., 704 F.2d 254 (6th Cir. 1983); *In Re Hansen*, 702 F.2d 728, 729 (8th Cir. 1983); *In Re Braniff Airways, Inc.*, 700 F.2d 214 (5th Cir. 1983), *cert. denied*, 461 U.S. 944 (1983); *Accord, Coastal Steel Corporation v. Tilghman Wheelabrator, Ltd.*, 709 F.2d 190 (3d Cir. 1983).

The Court of Appeals for the Ninth Circuit has expressly upheld the constitutionality of the Emergency Rule for the Central District of California, and rules similar to this local Emergency Rule have also been consistently upheld by those courts which have dealt with the issue. *See, In re Thomas, supra; In Re Kaiser, supra, In Re Stewart*, 741 F.2d 127, 129 (7th Cir. 1984); *In Re Hansen, supra; Oklahoma Health Services, Etc. v. Webb, supra; White Motor Corp. v. Citibank, N.A., supra.* The power of the district court to promulgate rules necessary and appropriate for the conduct of its business, and thus to create the automatic reference of bankruptcy cases to the bankruptcy judges, is expressly established in 28 U.S.C. Section 2071. A copy of the Emergency Rule for the Central District of California is attached hereto as Appendix 2.

Although the proceeding at issue is clearly a "core" proceeding arising under the bankruptcy laws, out of an abundance of caution, the Bankruptcy Court submitted the findings of fact and conclusions of law, a report and recommendation, and a proposed judgment to the District

Court for review and entry of judgment.[4] The constitutionality of a bankruptcy judge making final determinations in "core" bankruptcy proceedings was not disputed by this Court in the *Marathon* decision. Nevertheless, even if, *arguendo*, the proceeding at issue was a "related" proceeding, the procedures followed by the Bankruptcy Court in referring the matter to the District Court for a final determination comport with both the spirit and the letter of the law under *Marathon*.

B. The District Court Properly Reviewed the Bankruptcy Court's Determination and Properly Entered Judgment in Favor of All the Defendants.

Petitioners make the unsupported assertion that the District Court did not adequately review the Bankruptcy Court's findings and proposed judgment in this case. Petitioners cite Rule (e)(2)(B) of the Emergency Rule for the Central District of California and properly acknowledge that the district judge has broad discretion in determining the manner in which his or her review will be conducted. *See*, Petition for Writ of Certiorari, page 17.

It has become a maxim of law that the concept of due process is flexible and requires only that procedural safeguards and opportunities appropriate to the nature of the case be provided. *See, e.g.* , *United States v. Raddatz*,

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[4] The Emergency Rule expressly provided that the bankruptcy judge in his discretion could submit findings, conclusions and a proposed judgment to the District Court for review and entry of a final order if the bankruptcy judge determined that procedure to be appropriate under the circumstances of the case. *See* Section (d)(3)(B) of the Emergency Rule.

447 U.S. 667 (1980); *Mathews v. Eldridge*, 424 U.S. 319 (1976). The right to due process does not permit a litigant to ignore the procedures available for review and later complain of a violation of his or her due process rights.

In the case at bar, almost seven weeks passed between the conclusion of the trial and the submission of the findings of fact and conclusions of law to the Bankruptcy Court. The Bankruptcy Court then held the findings and conclusions for an additional week to permit Petitioners to make objections or to submit their own proposed findings or other pleadings to the Court. Petitioners were fully aware of the procedures which the Court would employ and of their right to request a new trial or to seek to amend the judgment or findings. As Mr. Galardi stated on July 18, 1983 at the close of trial:

> Why don't we go ahead and have the findings and conclusions submitted by defendants, as the Court indicated it is inclined to rule in favor of defendants as represented by Mr. Graham? *And I'll have five days within which to submit counterproposed findings and conclusions.* The court may elect to adopt some of them. *And then under the Rules I have ten days within which to move to amend anything that the Court actually signs.*" (Emphasis added.) R.T. July 18, 1983, 194:6-14.

Petitioners took none of the steps available to them to attempt to modify the Bankruptcy Court's determinations or enhance the review by the District Court. Analogous cases have dealt with the *de novo* review of a magistrate's decision and the effect of a party's failure to take advantage of the opportunities available to the unsuccessful litigant. These cases stand for the proposition that Petitioners cannot

complain when they have failed to avail themselves of the procedures available. *See, e.g., Nettles v. Wainwright*, 677 F.2d 404, (5th Cir. 1982) ("[i]f a party has objections, it is essential that he apprise the district court").

The rationale for this rule was well-stated by the Court in the *Nettles* case:

> . . . no undue burden exists in requiring an attorney or a pro se litigant to state his objections, if any, to the district court. . . . Requiring them to assist the district court by stating their objections is a small order. *We will not sit idly by and observe the 'sandbagging' of district judges where an appellant fails to object to a magistrate's report in the district court and then undertakes to raise his objections for the first time in this court.* (Emphasis added.) *Id.* at 410.

When a party fails to object to the findings of a magistrate and when the district court adopts those findings and enters a judgment or an order in accordance therewith, no explanation or statement need be given by the district court to support its decision. As the Court of Appeals for the Fourth Circuit has stated:

> Adoption is an affirmative act. In the absence of objection, for which provision is made by the statute, we do not believe that it requires any explanation. *We also do not believe it may be presumed by the absence of explanation, as plaintiff requests us to do, that the judge who entered the order adopting the Magistrate's report had not given the report any consideration at all. Indeed, quite the contrary is true for official acts are presumed to be regular,* and since the judge had the power either to accept, reject, or

> modify the report in whole or in part, we will not consider that the judge did not exercise the discretion which the statute gives him." (Emphasis added.) *Camby v. Davis*, 718 F.2d 198, 198, 199 (4th Cir 1983).

The papers submitted to the District Court in this case consisted of more than 70 separate and detailed findings of fact and three pages of conclusions of law specifically addressing each of the legal issues raised by Petitioners. The District Court had before it more than enough information to be apprised of the nature of the lawsuit and the events of the trial.

The Court of Appeals for the Ninth Circuit specifically found that the district judge conducted an appropriate review in light of the failure of Petitioners to submit objections or any other pleadings or papers to the Bankruptcy Court or the District Court. The Ninth Circuit found that the district judge acted as the ultimate decision-maker, satisfying the requirements of due process and Article III of the Constitution. Petitioners' constitutional rights have been adequately safeguarded in light of the lengthy trial before the Bankruptcy Court and the full review of the case by both the District Court and the Court of Appeals.

V

THE DISTRICT COURT HAD AUTHORITY TO APPOINT JUDGE SEYMOUR TO SIT AS A BANKRUPTCY JUDGE.

Judge Seymour was appointed by the District Court pursuant to express statutory authority. Specifically,

Section 404(a) of the Bankruptcy Reform Act of 1978, Public Law 95-598, states in pertinent part:

> The courts of bankruptcy, as defined under Section 1(10) of the Bankruptcy Act, created under Section 2(a) of the Bankruptcy Act, and existing on September 30, 1979, shall continue through March 31, 1984, to be the courts of bankruptcy for the purposes of this Act and the amendments made by this Act.

Section 1(10) of the Bankruptcy Act defines "courts of bankruptcy" as the district courts. Thus, during the transition period, the powers of the district court concerning the administration of bankruptcy cases were to remain in effect as they had been under the Bankruptcy Act of 1898. *See also, Collier on Bankruptcy*, 15th Ed., Vol. 1, ¶ 2.01, pp. 2-12.

Section 404(d) of the Bankruptcy Reform Act of 1978 states that during the transition period, matters relating to bankruptcy judges shall continue to be governed by certain provisions of the Bankruptcy Act of 1898, including Section 40(d) of the Act. Section 40(d)(2) of the Act provides in pertinent part:

> Any referee who has retired or been retired under the provisions of paragraph (1) of this subdivision may, if called upon by a judge of a court of bankruptcy, perform such duties of a referee, conciliation commissioner, or special master under this Act, within the jurisdiction of the Court, as he may be able and willing to undertake.

The District Court, under the powers conferred by the Bankruptcy Act and the transition statutes, called upon Judge Seymour to serve as a bankruptcy judge. The order appointing Judge Seymour under the authority of the

above-cited statutes was made a part of the record on appeal.

VI

PETITIONERS HAVE RAISED NO CLAIMS TO JUSTIFY REVIEW ON CERTIORARI.

No important or special issue of law has been presented by Petitioners which would warrant this Court's grant of the Petition for Writ of Certiorari. To the contrary, the judgment of the District Court and the decision of the United States Court of Appeals for the Ninth Circuit affirming that judgment are firmly grounded in substantial, well-reasoned and well-settled law.

VII

CONCLUSION

For the reasons set forth herein, and based upon the foregoing arguments and authorities, Respondent respectfully submits that the Petition for Writ of Certiorari should be denied.

Dated: March 10, 1986

Respectfully submitted,

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APPENDIX 1

No. 83-6385

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

In re:
LAWRENCE J. GALARDI, a professional corporation, and SHARI J. GALARDI,
Debtors.

LAWRENCE J. GALARDI and SHARI J. GALARDI,
Plaintiffs-Appellants,
vs.
TOKAI BANK OF CALIFORNIA, a California corporation, et al.,
Defendants-Appellees.

APPELLEE'S BRIEF

I

STATEMENT OF THE CASE

The litigation arises out of an auction sale of two parcels of real property which had been property of the appellants' bankruptcy estate. The auction sale was conducted by the Chapter 7 bankruptcy trustee pursuant to a November 24,

1982 order of the bankruptcy court approving the sale. This appeal represents the final chapter in the saga of appellants' improper efforts to thwart the bankruptcy trustee's sale of the properties.

The appellants' sought to set aside the auction sale by filing a complaint for declaratory and injunctive relief in the bankruptcy court. The complaint alleged that the bankruptcy court did not have jurisdiction over the subject matter raised in the complaint, that the auction sale conducted pursuant to the court order was illegal and void, that the appellees violated the automatic stay of 11 U.S.C. § 362 by conducting the auction, and that an injunction should issue restraining the appellees, including the trustee, from taking possession or otherwise disposing of the two parcels of real property. On appeal, appellants have apparently waived their request for the above-described relief and have requested only that this Court remand the case for trial on the issue of damages allegedly resulting from the trustee's sale of one of the two real properties. (Appellants' Opening Brief, pp. 6, 45, 46.)

A. Procedural History Of The Case

Appellants Lawrence and Shari Galardi filed their petition under Chapter 11 of the Bankruptcy Code on January 20, 1981, Bankruptcy Case Number LA 81-00606. On October 1, 1981, an order was entered directing the appointment of a trustee and David A. Gill, an appellee herein, was so appointed. The Chapter 11 proceeding was subsequently converted to a Chapter 7 liquidation proceeding on July 23, 1982, and David A. Gill was appointed as trustee of the Chapter 7 estate. (Appellants' Appendix, Vol. II, p. 346, hereinafter "App.".)

The assets of appellants' Chapter 7 bankruptcy estate included two parcels of real property known as the Cool Oak Way property (also known as the 29 acres property) and the Eagle Pass property. Appellee Tokai Bank was the holder of first position deeds of trust on each of the two properties. Defendant Cambridge Capital Group was the holder of a second deed of trust on the Eagle Pass property.[1] (App., Vol. II, pp. 243-249.)

1. The Order Approving the Auction Sale

On October 18, 1982, Tokai Bank and the trustee filed a joint application to conduct a public auction sale of the two properties. (App., Vol. II, p. 346.) On November 24, 1982, the bankruptcy court entered an order granting the application and directing that the two properties be sold. The order further provided that the trustee was authorized to employ Marsh Dozar as the auctioneer and approved Tokai Bank's allowed secured claim. The order also approved Tokai Bank's minimum credit bid for the Cool Oak Way property and approved the terms for a qualified buyer to make a financed bid. (App., Vol. II, p. 347.)

Appellants subsequently appealed the court's November 24, 1982 order to the Bankruptcy Appellate Panel on December 13, 1982, one day after the auction sale was conducted. Appellants at no time sought a stay of the order. Appellants failed to prosecute that appeal, and the appeal was dismissed on December 6, 1983. (App., Vol. II, p. 350.)

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[1] Cambridge Capital Group was dismissed from this appeal by appellants. (Appellants' Opening Brief, p. 2, fn. 2.)

2. The Intervening Bankruptcy of Heatherfield Interiors

On December 9, 1982, three days prior to the scheduled auction sale, appellant Shari Galardi created Heatherfield Interiors, Inc., a California corporation. The debtor Shari Galardi was the sole shareholder of that corporation. On the same date that Heatherfield Interiors, Inc. was incorporated, Shari Galardi purportedly transferred all of her right, title and interest in the Cool Oak Way and Eagle Pass properties to the corporation. (App., Vol. II, pp. 246-247.)

This "transfer" of assets of the Galardi bankruptcy estate was made without the knowledge or consent of the bankruptcy trustee or the bankruptcy court. (App., Vol. II, p. 247.) On the following day, December 10, 1982, Heatherfield Interiors, Inc. filed a petition under Chapter 11 of the Bankruptcy Code, listing the two parcels of real property as assets of Heatherfield despite the fact that title to the properties had been vested in the Galardis' bankruptcy estate for almost two years. (App., Vol. II, pp. 241-252.)

The "claim" of Heatherfield Interiors, Inc. to the Cool Oak Way and Eagle Pass properties was the subject of an adversary proceeding commenced by Heatherfield Interiors, Inc. against Cambridge Capital Group, Tokai Bank and others. *Heatherfield Interiors, Inc. v. Cambridge Capital Group, etc., et al.*, Adv. No. LA 83-2003 RS. The matter was tried before Bankruptcy Judge Russell B. Seymour. (App., Vol. II, pp. 237-239.) A judgment was entered against appellants and in favor of all defendants in that action, and the findings of fact and conclusions of law, the report and recommendation, certification for review,

and judgment in that proceeding were admitted into evidence in the trial on this matter. (App., Vol. II, pp. 233-252, Def. Ex. 107-109.)

The auction sale of the real properties was conducted on December 12, 1982. The Cool Oak Way property was sold to Tokai Bank at the price previously approved by the bankruptcy court because no other bids were made on the property. The sale of the Eagle Pass property was conducted *with reserve* pursuant to the court's prior order. (App., Vol. I, pp. 49-55.) The highest bid for the Eagle Pass property was $1 million; however, at least $1.5 million dollars was needed to pay the allowed secured claims of Tokai Bank and Cambridge Capital Group. Because a $1 million bid was insufficient to pay the liens on the property, the $1 million bid was rejected by the trustee's attorney. (Def. Ex. 100.)

3: The Adversary Proceeding

On January 20, 1983, appellants filed an application requesting relief similar to that prayed for in the subject adversary proceeding. (App., Vol. II, p. 348.) Because of the evidentiary nature of the dispute, the bankruptcy court converted the matter to an adversary proceeding pursuant to Bankruptcy Rule 9014. The order dismissing the application was signed by the court on March 18, 1983. (App., Vol. I, p 89; App., Vol. II, p. 348.) Thereafter, appellants filed their complaint for declaratory and injunctive relief, which adversary proceeding is the subject of this appeal.

The bankruptcy court's jurisdiction over the adversary proceeding was based on the Emergency Rule for the Central District of California, promulgated after the stay of

the *Marathon* decision expired. The bankruptcy judge made findings of facts and conclusions of law, a report and recommendation, and a proposed judgment was referred the matter to the district court. Judgment was entered on September 26, 1983 and notice of appeal was filed on October 24, 1983. (App., Vol. I, pp. 1, 26.)

B. Factual History Of The Case

The subject properties are located in Malibu, California. The Cool Oak Way property consists of 28.71 acres of undeveloped land. (Pl. Ex. 7.) The Eagle Pass property is comprised of 8 acres of land with a partially completed large Tudor-style mansion. (Pl. Ex. 7.) Mr. and Mrs. Galardi were the vested owners of the Cool Oak Way property and Lawrence Galardi was the vested owner of the Eagle Pass property. (App., Vol. II, p. 243.)

Appellee Tokai Bank was the construction lender for the large, Tudor-style mansion on the Eagle Pass property.[2] The construction project suffered set-backs and cost overruns, and the Galardis ultimately filed a petition in bankruptcy.

The Eagle Pass and Cool Oak Way properties were the primary assets of the Galardi bankruptcy estate. After 18 months, the reorganization proceeding was unsuccessful and the proceeding was converted to a Chapter 7 case. The Chapter 7 trustee then proceeded to liquidate the assets of the Galardis' estate.

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[2] Plaintiffs' Exhibit 17, the loan documents on these properties, was admitted into evidence at trialand isone of the exhibits which was lost. (App., Vol. II, pp. 243-244.)

The trustee and the primary lien holders on the properties entered into stipulations to provide for an orderly sale of the properties. (App., Vol. II, pp. 272-276, pp. 213-216.) The letter agreement between Tokai Bank and the trustee, dated October 8, 1982 (Def. Ex. 103), provided for a $641,000.00 minimum credit bid on the Cool Oak Way property and Tokai Bank guaranteed the payment of certain auction expenses and commissions. In addition, Tokai Bank offered financing to 243-244.) prospective purchasers.[3] The Court ultimately approved the auction sale of the properties pursuant to its order of November 24, 1982. (Pl. Ex. 1.)

1. Pre-Auction Maneuvers and the Creation of Heatherfield Interiors, Inc.

One week prior to the scheduled auction, appellants presented to the attorney for the trustee an offer to purchase the properties.[4] This offer, which was contingent

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[3] This October 8, 1982 letter agreement is also known as the "confidential letter agreement". Appellants have placed before this Court an inaccurate copy of the letter agreement with the words "in error" in Mr. Galardi's handwriting. (Pl. Ex. 6; App., Vol. II, pp. 184-192.) This exhibit was excluded when defendant produced the original letter, Defendant's Exhibit 103. (R.T., June 27, 1983, pp. 1-3.) Copies of the letter agreement were distributed to the interested parties at the hearing on the application to approve the auction sale, but the agreement was otherwise kept confidential to encourage competitive bidding by not disclosing to the public the minimum acceptable bids. [R.T., June 23, 1983, p. 24, lines 4-8.]

[4] This offer, Plaintiffs' Exhibit 13, named Douglas Blankenship, the Galardis' alleged partner, as the sole purchaser and was signed by Kenneth Hardin, purportedly as agent for Mr. Blankenship. (App., Vol. II, pp. 208-209.) In his testimony at trial, Mr. Blankenship denied that there was a partnership between he and the Galardis and denied that

upon obtaining financing and did not include an earnest money deposit, was rejected by the attorneys for the trustee (R.T., June 24, 1983, page 168, lines 11-17; June 30, 1983, page 116, lines 21-24.)

The Galardis then implemented a thinly-veiled scheme to cloud title to the properties and to discourage bidders at the auction sale. On December 9, 1982, three days before the scheduled auction sale, Shari Galardi incorporated an entity known as Heatherfield Interiors, Inc., a California corporation. On the same date, Shari Galardi purported to transfer the Cool Oak Way property and the Eagle Pass property from the Galardi bankruptcy estate to Heatherfield Interiors, Inc.

On December 10, 1982, at 4:07 p.m., the entity Heatherfield Interiors, Inc. filed a Chapter 11 petition in bankruptcy and scheduled the Cool Oak Way and Eagle Pass properties as assets of the Heatherfield bankruptcy estate. (Def. Ex. 109; Def. Ex. 101.) The sham nature of the corporation and its alleged interest in the Cool Oak Way and Eagle Pass properties were fully proven in the Heatherfield adversary proceeding. The judgment in that proceeding is final and no appeal was ever taken from that judgment.

The findings of fact and conclusions of law which were admitted into evidence at trial conclusively determined that the subject properties had at all times been property of the Galardi bankruptcy estate, and that the purported transfer to Heatherfield Interiors was made without the knowledge or consent of the trustee or the bankruptcy court. (Def. Ex.

Mr. Hardin had authority to submit the purchase offer (R.T. June 30, 1983, p. 170, lines 22-25, p. 171, line 1, p. 174, lines 2-13, p. 190, p. 175, lines 2-20.)

109, App. Vol. II, pp. 241-252; R.T., June 29, 1983, p. 75, lines 5-19, p. 76, lines 5-9, pp. 204-105.)

2. Appellants' Activities at the Auction Sale

In an effort to confuse the bidders and forestall the auction, appellants posted notices of the Heatherfield bankruptcy filing in several obvious locations around the Eagle Pass property on the day the auction was to take place. Specifically, appellants posted notices stating that Heatherfield Interiors, Inc. had an interest in the Cool Oak Way and Eagle Pass properties, that Heatherfield had filed a Chapter 11 petition, and that the automatic stay of 11 U.S.C. § 362 prohibited the sale or other disposition of any Heatherfield property. (Def. Ex. 101; R.T., June 29, 1983, p. 73, line 25, p. 74, lines 1-20.)

Mr. Galardi specifically requested that the auction sale be cancelled (R.T., June 23, 1983, p. 18, lines 20-24). When Leslie Cohen, one of the attorneys for the trustee, attempted to remove the Heatherfield notices, Mr. Galardi admonished her not to remove them. When she did remove them, Mr. Galardi called the county sheriff in a further attempt to create confusion and disrupt the sale (R.T., June 24, 1983, p. 184, lines 6-25, p. 185, lines 2-10). When Bennett Silverman, the attorney for Cambridge Capital Group, attempted to remove one of the notices, a friend of the Galardis attempted to restrain him from doing so (R.T., July 12, 1983, p. 38, lines 10-25, p. 39, lines 1-21.)

A good friend of the Galardis, John Corrodi, arrived at the auction with his seven children with no intention to bid (R.T., June 22, 1983, pp. 46-47). Although Mr. Corrodi was not a qualified bidder and had indicated to the auctioneers

that he was not there to bid, Mr. Corrodi attempted to disrupt the auction by questioning the auctioneers regarding the Heatherfield bankruptcy. (R.T., June 23, 1983, p. 3; June 24, 1983, p. 182 lines 3-10.)[5]

3. The Auction Sale

The tape recording of the auction sale, Defendant's Exhibit 100, demonstrates that numerous attempts were made to obtain bids from the public. The property was offered on both a cash and a terms basis in accordance with the court order. (R.T., June 23, 1983, p. 50, lines 17-23.) After waiting for several minutes and attempting to obtain a bid, the auctioneer sold the property to Tokai Bank at the court-approved price. (R.T., June 24, 1983, p. 96, lines 5-19.) Some months later, Tokai Bank resold the Cool Oak Way property to Donald L. Lewis. (App., Vol. II, p. 183.)

The autcioneers then proceeded to auction the Eagle Pass property *with reserve.* Bidding opened at $1 million cash and Douglas Blankenship, the alleged partner of Galardi, made a bid in that amount (R.T., June 24, 1983, p. 19, lines 3-9, lines 15-19.) No bids in a higher amount were received, and the attorney for the trustee rejected the $1 million bid since it was insufficient to pay the allowed secured claims of Tokai Bank and Cambridge Capital Group.

Bidding was opened on a financed basis and again Blankenship bid $1 million. The trustee rejected that bid and indicated that a bid of at least $1.5 million was required

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[5] Mr.Corrodi was aware of the Heatherfield matter since he had discussed the Heatherfield filing with the attorney who filed the Heatherfield bankruptcy petition and was present at the attorney's office at the time the Galardis were there. (R.T., June 22, 1983, p. 72, lines 3-18, p. 73, lines 9-16.)

to satisfy prior liens on the property. No further bids were forthcoming. (Def. Ex. 100; R.T., June 24, 1983, p. 171, lines 8-13, p. 172, lines 18-21, p. 124, lines 14-25, p. 125, lines 1-25, p. 126, lines 1-4; July 12, 1983, p. 34, lines 9-25, p. 35, lines 1-17, p. 36, lines 3-8.)

4. Post-Auction Litigation

Arguing that the auction sale was "confusing" and that bidding was somehow precluded, appellants challenged the conduct of the auction in the pending litigation.[6]

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[6] Appellants only called three independent witnesses to support their claim of "confusion" and "unfairness" although there were approximately 85 people at the auction, most of whom were friends of the Galardis. (R.T., June 29, 1983, p. 71, lines 18-25.) The strength and credibility of the witnesses' testimony will be discussed in detail in the latter portions of this brief.

APPENDIX 2

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

LOCAL RULE GOVERNING BANKRUPTCY CASES AND PROCEEDINGS

(a) Emergency Resolution

The purpose of this rule is to supplement existing law and rules in respect to the authority of bankruptcy judges of this district to act in bankruptcy cases and proceedings until Congress enacts appropriate remedial legislation in response to the Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, __U.S__, 102 S.Ct. 2858 (1982), or until March 31, 1984, whichever first occurs.

The judges of the District Court find that exceptional circumstances exist. These circumstances include: (1) the unanticipated unconstitutionality of the grant of power to bankruptcy judges in Section 241(a) of the Bankruptcy Act of 1978; (2) the clear intent of Congress to refer bankruptcy matters to bankruptcy judges; (3) the specialized expertise necessary to the determination of bankruptcy matters; and (4) the administrative difficulty of the District Court's assuming the existing bankruptcy caseload on short notice.

Therefore, the orderly conduct of the business of the court requires this referral of bankruptcy cases to the bankruptcy judges.

(b) Filing of bankruptcy papers

Bankruptcy cases and related proceedings shall be filed with the Bankruptcy Clerk and assigned to bankruptcy judges, including those matters to be reviewed by a District Court Judge.

In all pleadings after referral by a bankruptcy judge to a District Court Judge, the caption shall contain the following notice: "REFERRED TO U.S. DISTRICT COURT".

The court of bankruptcy constituted by Section 404 of the Bankruptcy Act of 1978 shall continue to be known as the United States Bankruptcy Court of this district. The Clerk of the Bankruptcy Court is hereby designated to maintain all files in bankruptcy cases and adversary proceedings. All papers in cases or proceedings arising under or related to Title 11 shall be filed with the Clerk of the Bankruptcy Court regardless of whether the case or proceeding is before a bankruptcy judge or a judge of the District Court, except that a judgment by the District Judge shall be filed in accordance with Rule 921 of the Bankruptcy Rules. Upon reference to a United States District Judge the moving party shall give notice to affected parties, advising them of the requirement that subsequent pleadings shall identify the District Judge to whom the matter has been referred.

The moving party shall also provide the District Court with a list of the names and addresses of all parties served.

In any matter to be heard before a District Judge under these Rules, the Local Rules of the District Court must be strictly complied with, including the requirement that documents presented for filing must be accompanied by a legible copy for the use by the District Judge. The Clerk of the Bankruptcy Court is authorized to reject any filing which does not comply with the requirement of this Local Rule.

(c) Reference to Bankruptcy Judges

(1) All cases under Title 11 and all civil proceedings arising under Title 11 or arising in or related to cases under

Title 11 are referred to the bankruptcy judges of this district.

(2) The reference to a bankruptcy judge may be withdrawn at any time by the District Court on its own motion or on timely motion by a party. A motion for withdrawal of reference shall not stay any bankruptcy matter pending before a bankruptcy judge unless a specific stay is issued by the District Court. If a reference is withdrawn, the District Court may retain the entire matter, may refer part of the matter back to the bankruptcy judge, or may refer the entire matter back to the bankruptcy judge with instructions specifying the powers and functions that the bankruptcy judge may exercise. Any matter in which the reference is withdrawn shall be reassigned to a District Judge in accordance with the court's usual system for assigning civil cases.

(d) Powers of Bankruptcy Judges

(1) The bankruptcy judges may perform in referred bankruptcy cases and proceedings all acts and duties necessary for the handling of those cases and proceedings except that the bankruptcy judges may not conduct:

(A) a proceeding to enjoin a court;

(B) a proceeding to punish a criminal contempt —

(i) not committed in the bankruptcy judge's actual presence; or

(ii) warranting a punishment of imprisonment;

(C) an appeal from a judgment, order, decree, or decision of a United States bankruptcy judge; or

(D) jury trials.

Those matters which may not be performed by a bankruptcy judge shall be transferred to a District Judge.

(2) Except as provided in (d)(3), orders and judgments of bankruptcy judges shall be effective upon entry by the Clerk of the Bankruptcy Court, unless stayed by the bankruptcy judge or a District Judge.

(3) (A) Related proceedings are those civil proceedings that, in the absence of a petition in bankruptcy, could have been brought in a District Court or a state court. Related proceedings include, but are not limited to, claims brought by the estate against parties who have not filed claims against the estate. Related proceedings do not include: contested and uncontested matters concerning the administration of the estate; allowance of and objection to claims against the estate; proceedings to lift the automatic stay; counterclaims by the estate in whatever amount against persons filing claims against the estate; proceedings to set aside preferences and fraudulent conveyances; orders to turn over property of the estate; orders authorizing use of cash collateral; orders approving the sale of property of the estate free and clear of liens; allowance or denial of discharge; proceedings to determine the dischargeability of a debt; proceedings regarding the confirmation of a plan; and similar matters. A proceeding is not a related proceeding merely because the outcome wil be affected by state law.

(B) In related proceedings, and wherever the bankruptcy judge determines that circumstances require that a judgment or order be entered by a District Judge, the bankruptcy judge shall not enter a judgment or dispositive order, but shall submit findings, conclusions, and a proposed judgment or order to the District Judge, unless the parties to the proceeding consent to entry of judgment or order by the bankruptcy judge.

(e) District Court Review

(1) A notice of appeal from a final order or judgment or proposed order or judgment of a bankruptcy judge or an application for leave to appeal an interlocutory order of a bankruptcy judge, shall be filed within ten (10) days of the date of entry of the judgment or order or of the lodgment of the proposed judgment or order. Modification by the District Judge or the bankruptcy judge of time for appeal is governed by Rule 802 of the Bankruptcy Rules. The procedures set forth in Part VIII of the Bankruptcy Rules apply to appeals of bankruptcy judges' judgments and orders except that:

(A) The provisions of Sections (e)(2)(A) and (e)(2)(B) of this rule shall apply;

(B) The procedural modifications set forth in Bankruptcy Interim Rule 8004 shall apply pertaining to applications for leave to appeal interlocutory orders; and

(C) The form and contents of record on appeal shall comply with Rules 4(b) and 9(a) and (b) of the Rules of the United States Bankruptcy Appellate Panels of the Ninth Circuit.

(2) (A) A District Judge shall review:

(i) an order or final judgment entered under Section (d)(2) if a timely notice of appeal has been filed or if a timely application for leave to appeal has been granted;

(ii) an order or final judgment entered under Section (d)(2) if the bankruptcy judge certifies that circumstances require that the order or judgment be approved by a District Judge, whether or not the matter was controverted before the bankruptcy judge or any notice of appeal or application for leave to appeal was filed; and

(iii) a proposed order or judgment lodged under Section (d)(3), whether or not any notice of appeal or application for leave to appeal has been filed.

(B) In conducting review, the District Judge may hold a hearing and may receive such evidence as appropriate and may accept, reject, or modify, in whole or in part, the order or judgment or proposed order or judgment of the bankruptcy judge, and need give no deference to the findings of the bankruptcy judge. At the conclusion of the review, the District Judge shall enter an appropriate order or judgment.

(3) When the bankruptcy judge certifies that circumstances require immediate review by a District Judge of any matter subject to review under Section (e)(2), the District Judge shall review the matter and enter an order or judgment as soon as possible.

(4) It shall be the burden of the parties to raise prior to the time of the entry of the order or judgment of the District Judge after review the issue whether the bankruptcy judge should have entered a proposed judgment or order under Section (d)(3) rather than an order under Section (d)(2).

(5) The provisions of 11 U.S.C. § 363(m) and § 364(e) are incorporated by reference into these rules to apply to any action taken in good faith pursuant to an order of the bankruptcy judges.

(f) Local Rules

In proceedings before a bankruptcy judge the Local Rules of the Bankruptcy Court shall apply. In proceedings before a District Judge, the Local Rules of the District Court shall apply.

(g) Bankruptcy Rules and Title IV of the Bankruptcy Act

Courts of bankruptcy and procedure in bankruptcy shall continue to be governed by Title IV of the Bankruptcy Act of 1978 as amended and by the Bankruptcy Rules prescribed by the Supreme Court of the United States pursuant to 28 U.S.C. § 2075 and limited by Section 405(d) of the Act, to the extent that such Title and Rules are not inconsistent with this rule and the holding of *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, __U.S__, 102 S.Ct. 2858 (1982).

(h) Effective Date and Pending Cases

This rule shall become effective December 25, 1982, and shall apply to all bankruptcy cases and proceedings not governed by the Bankruptcy Act of 1898, as amended, and filed on or after October 1, 1979. Any bankruptcy matters pending before a bankruptcy judge on December 25, 1982 shall be deemed referred to that judge.

I. Preliminary Matters

1. *Emergency Resolution* [(a)]

The purpose of this rule is to supplement existing law and rules in respect to the authority of bankruptcy judges of this district to act in bankruptcy cases and proceedings until Congress enacts appropriate remedial legislation in response to the Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, __U.S__, 102 S.Ct. 2858 (1982), or until March 31, 1984, whichever first occurs.

The judges of the District Court find that exceptional circumstances exist. These circumstances include: (1) the unanticipated unconstitutionality of the grant of power of bankruptcy judges in Section 241(a) of the Bankruptcy Act of 1978; (2) the clear intent of Congress to refer bankruptcy

matters to bankruptcy judges; (3) the specialized expertise necessary to the determination of bankruptcy matters; and (4) the administrative difficulty of the District Court's assuming the existing bankruptcy caseload on short notice.

Therefore, the orderly conduct of the business of the court requires this referral of bankruptcy cases to the bankruptcy judges.

2. *The Bankruptcy Court is Alive and Well* [(b) 3rd ¶]

The court of bankruptcy constituted by Section 404 of the Bankruptcy Act of 1978 shall continue to be known as the United States Bankruptcy Court of this district.